IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-832

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,

Petitioner,

vs.

FIRST LINCOLNWOOD CORPORATION,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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TABLE OF CONTENTS

LIST OF AUTHORITIES CITED

Cases

Other Authorities

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The Respondent, First Lincolnwood Corporation, submits that a writ of certiorari should not be granted in this cause.

STATEMENT

The Respondent supplements the Solicitor General's Statement:

The application for bank holding company status of First Lincolnwood Corporation had the approval of the Comptroller of Currency, the Federal Reserve Bank for the Seventh District, and was not opposed by any person, public official, or competing entity. App. 18a & p. 3, *Appellant's Appendix, 7th Cir.* Illinois is a state

which forbids branch banking and chain banking; under Illinois law no bank holding company may own more than one bank. See *Ill. Constitution 1970*, Art. 13, Sec. 8. This holding company did not seek permission to engage in any non-banking enterprise; its only function would be to own stock in the bank, and to provide for the ownership of the bank that tax benefit described at note 4 page 7, of the petition.

The debt attributable to the present ownership of the bank arose when the present owners of the bank bought out certain predecessors who had been convicted of crime. The Seventh Reserve District Report said:

> "The current debt position of the principals is directly tied to acquisition of additional control of bank, and at the same time exercising this control to improve its daily operation and general condition. We believe this control is fundamental to the current well being of the bank, thus, it seems inappropriate to penalize the principals for their accomplishments using debt, by denying their plans for reorganization when their past actions generally support approval of the proposal. The holding company structure will enhance bank's prospects for capital retention." (p. 3), Appendix to Brief of Appellant, 7th Cir., 76-1114).

The Court of Appeals said, in its initial opinion:

> "All parties now agree that the bank's present management . . . is outstanding and has converted the bank to its now favorable condition." (App. 19a).

The transfer from individual ownership, held through a voting trust, to holding company status has absolutely no effect on the existence of or liability for debt; on competition; on the actual identity of ownership; or on management. It will allow a tax deduction for interest paid, and will subject the resulting entity to regulation by the Federal Reserve Board.

REASONS FOR DENYING THE WRIT

I.

THE DECISION BELOW IS ENTIRELY CONSISTENT WITH PRIOR DECISIONS AND WITH THE LEGISLATIVE HISTORY OF THE BANK HOLDING COMPANY ACT.

The statute, Section 3 of the Bank Holding Company Act, as amended, would appear, on its face, to be directed toward anti-trust considerations. (Petition, p. 3) The original legislative history indicated that it was passed because "the dangers accompanying monopoly in this field are particularly undesirable . . ." Senate Report 1095, 84th Congress, p. 1. The 1966 Senate report says that "It was intended to apply in the field of banking and bank holding companies the general purposes of the antitrust laws—to promote competition and to prevent monopoly, and the general purposes of the Glass-Steagall Act of 1933—to prevent unduly extensive connections between banking and other businesses." Senate Report 1179, 89th Congress, p. 2.

In 1966 Congress rejected an attempt to make single bank holding companies subject to the Act, but amended the act to avoid the decisions of this Court in *U.S. v. Philadelphia National Bank*, 374 U.S. 321 (1963) and *U.S. v. First National Bank and Trust Co.*, 376 U.S. 665 (1964). See *Bank Holding Company Regulatory Experience Since 1970*, 8 Indiana L. Rev. 942, 944 (1974-1975). Those cases held, in substance, that, no matter how benign, no anti-competitive merger or acquisition could be allowed. The 1966 amendments gave the Federal Reserve Board the power to approve such transactions if "the anti-competitive effects of the proposed transactions are clearly outweighed in the public interest by the

probable effect of the transaction in meeting the convenience and needs of the community to be served." 12 USC 1842(c)(2).

Thus, the statute, in 1966, had the apparent purpose of allowing a balance between community needs and antitrust considerations. In 1970 the statute was made applicable to one bank holding companies because Congress was concerned that there be adequate safeguards "against the possibility of misuse of the economic power of a bank." *U.S. Code & Cong. Service, 1970,* p. 5535.

The purpose of the bill was to continue "a long standing policy of separating banking from commerce (*ibid,* p. 5522) and, according to a message from President Nixon to the Congress, to avoid "undue concentration of powers" in banks which combine their resources with non banking enterprises.

Governor Burns testified that, if the one-bank holding companies were to be brought under the Act, "the Board would then be simply regulating the bank holding companies, not the banks themselves . . .". Mr. Burns also said that "the . . . distribution of regulatory functions as far as the banks are concerned, would remain entirely unchanged . . ." (*ibid,* p. 5548).

The Federal Reserve Board, in describing the 1966 and 1970 amendments to the statute said that the statute "was designed to achieve two basic objectives. The first was to control bank holding company expansion in order to avoid the creation of monopoly or restraint of trade in banking. The second was to allow bank holding companies to expand into nonbanking activities that are related to banking while maintaining a separation between banking and commerce." The Federal Reserve Systems; Purposes and Functions, 1974 edition, p. 110.

The same publication said that the purpose of extending the Act to one bank holding companies was "to preserve the traditional separation of banking and commerce." (*ibid,* p. 111).

The legislative history of the 1970 amendment does not indicate that the Federal Reserve Board sought or claimed to have the power to deny permission for the formation of a holding company involving nothing more than a redenomination of an existing ownership structure into corporate form. In describing its work in its 1976 report the FRB said, of its Bank Holding Company activity:

> "In other instances, the Board denied proposals that would create, or add to, strains on the financial and managerial resources of the applicant company or any bank or nonbank company involved."

63rd Annual Report, Federal Reserve Board, p. 411 (1976). The report did not discuss denials based upon circumstances which were not affected by reason of the formation of the holding company.

This legislative history was reviewed in *Western Bancshares, Inc. v. Board of Governors,* 480 F.2d 749 (10th Cir. 1973). In that case the Board disapproved an acquisition on the ground that the transaction offered was not fair. The 10th Circuit held, after an examination of the legislative history, part of which we have outlined above, that the purpose of the 1970 amendments was to prevent "possible abuses or future concerns related to monopolistic practices, lessening of competition and extension of a line of credit to finance an unrelated business concern over which it had control."

That court held that the Board's concerns were "competition, tendency to create a monopoly, restraint of

trade, anticompetitive effect, or want in 'meeting the convenience and needs of the community to be served.' " That court found the legislative standard to be "present and declared," *Panama Refining Co. v. Ryan*, 293 U.S. 388, (1935), and reversed the Board, holding that it had no authority to adjudicate the fairness of a transaction. The Federal Reserve Board has ignored the holding, and still adjudicates fairness. *Jackson Hole Banking Corp.*, 63 Fed. Res. Bulletin 934 (Sept. 30, 1977).

In this case the Seventh Circuit denied to the Board the power to refuse an application which would have no practical effect on the competition, on the actual ownership of the bank, on the existence of an indebtedness against the bank's stock, incurred long before the holding company obligation, or on community convenience. There is no statutory requirement as to the capital requirements for a holding company, and the Court did not create one.

The Board has construed the decision below most narrowly in considering other applications for holding company status. In *Citizens Bancorp, Inc.*, decided November 18, 1977, the Board of Governors limited *First Lincolnwood* to its facts in denying an application.

The Board argues, at note 8, p. 11, that the legislative history shows, contrary to its own repeated statements in its own publications, that there was an intent to confer on the Board the duty of refusing a holding company application without regard to whether or not the allowance of the application would cause, increase, create or affect any financial or banking factor which might be present. The Board bases this argument on the repeal, in 1966, of the old "voting permit" statute, which related to "holding company affiliates" and not to statutory bank holding companies.

The problem was that a "holding company affiliate" was not so designated until it had over fifty cent of the stock of a bank, and further, that the statute should be repealed because "(T)heir elimination would remove the confusion that results from the existence of two sets of laws that relate to the same general subject but are based on different definitions of what constitutes a holding company." S. Rep. 1179, 89th Cong. 2d Sess. 12, par. 21 (1966). And, the "voting permit" approach allowed a holding company to avoid regulation (and many did) by simply not voting the stock of the subsidiary bank; the Act was designed to avoid this capability of regulation-avoidance.

The Petition's statement that "Thus, Congress explicitly had provided that a bank holding company should serve as a source of financial strength to its subsidiary bank" (Petition, p. 11, note 8) is not supported by any similar language in the legislative history or in the statute, and it has no basis external to the writings of the Federal Reserve Board.

And, the voting permit avenue of regulation had nothing to do with whether or not a holding company could be formed. It dealt with regulation of existing entities. The present litigation deals with whether or not a holding company may commence, and not with its regulation after commencement.

We believe it to be the clear purpose of the statute to implement an antitrust policy, and to keep banks out of unrelated businesses. Nothing in the statute says that entry is conditioned upon the holding company being of such strength as to add to the existing strength of the Bank, and this subject was simply not discussed in the legislative history, and is not to be found in the language of the statute.

We submit that the decision below is correct.

II.

THE BOARD SHOULD MAKE DETERMINATIONS UNDER THIS STATUTE AS JUDICIAL, AND NOT AS ECONOMIC, DECISIONS.

By its decision, the Court of Appeals requires the Federal Reserve Board to consider a bank holding company application against objective standards, and to allow this convenient method of ownership unless, by its allowance, some definable harm comes, or unless the direct regulator of the bank objects. This is a judicial standard, we submit, and does contradict the basic policy of the Federal Reserve Board. That policy was explained by Mr. Partee, of the Board, in a statement to the Congress, printed at 63 Fed. Res. Bulletin 819. He said, in opposing a bill to unify bank regulation under one Federal banking commissioner (not under the control of the FRB):

> ". . . the Board remains gravely concerned that the removal of its supervisory and regulatory responsibilities . . . would work adversely on the Board's effectiveness in carrying out its monetary policy functions."
>
> "If supervisory standards for bank performance are independently set, there is the very real risk that bank regulation could frustrate the objectives of monetary policy."

This case may be an example of some higher economic policy determining what must be done with a particularly mundane business situation. Ordinary local businessmen want to own their bank in corporate form. They are found to be honorable, capable, and responsive to the emergency thrust on them when it was necessary to buy out a part owner with a criminal record.[1] Their

[1] The acquisition of these shares was made with "some encouragement" from the Federal Reserve Bank of Chicago that a holding company application would be considered. (Appendix, 7th Circuit, Petitioner's Brief, p. 102).

shift to corporate ownership changes nothing as to debt or public convenience, and yet it is denied because the Federal Reserve Board determines that they might not be a "source of strength" to their bank if they are allowed to save $130,000 per year that they will otherwise lose.

It is surely not for us to judge the "monetary policy" of the United States; but this decision should be judged, as in the *Western Bancshares* case, against the defined standards and not as part of "monetary policy". *Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

We submit that the Court of Appeals correctly decided this case.

III.

THE DECISION OF THE COURT OF APPEALS LEAVES NO UNREGULATED AREAS WHICH SHOULD BE REGULATED.

At this time, the ownership of the First National Bank of Lincolnwood is in a voting trust, and is entirely unregulated. As an unregulated ownership, it has no requirements upon it at all; and, specifically, it need not be a source of strength to the Bank.

If the petition is denied, this ownership will, upon remand, become corporate, and it will then be subject to regulation under the Bank Holding Company Act.

The decision below, and the voluntary act of the owners of the Bank, *increase* the degree of regulation of the banking industry.

And, nothing is changed as to the direct regulation of the soundness of the bank; that is still the responsibility of the Comptroller of the Currency. 12 USC 26, 27, 57.

The petition argues, at note 12, p. 13, that the Federal Reserve Board examines banks directly; but its 1976 annual report says:

> "National Banks . . . are subject to examination by direction of the Board or the Federal Reserve Bank.
>
> "However, as a matter of practice, they are not examined by either because the law charges the Comptroller of the Currency directly with that responsibility."

63rd Annual Report of the Federal Reserve Board, p. 412 (1976).

If, then, it is considered that more regulation is better, the decision of the Court of Appeals, which allows regulation of the ownership of this bank where such regulation did not previously occur, is plainly right. The Seventh Circuit has, in other cases, found that the addition of another holding company to the Board's regulatory burden was not an undue hardship. *North Lawndale Economic & Development Corp. v. Board of Governors*, 533 F.2d 23 (7th Cir. 1977); *Tri-State Bancorp, Inc. v. Board of Governors*, 524 F.2d 562 (7th Cir. 1975).

IV.

THE FACTS OF THE CASE ARE SUCH AS TO MAKE IT UNLIKELY TO RECUR: THE CASE IS OF GREAT IMPORTANCE TO CERTAIN INDIVIDUALS, BUT IS NOT OF GREAT PUBLIC IMPORTANCE.

The Petition states the teachings of the decision below most broadly; but it is most narrowly viewed by the Federal Reserve Board (*Citizens Bancorp, Inc.*, FRB decision, 11/18/77). The holding, in substance, says that a change to corporate status of the ownership of a bank which is not anti-competitive, does not create any new debt, changes nothing in the operation of the bank, and

serves only to confer on this owner a tax benefit enjoyed by others, should not be denied, in the absence of some specific adverse fact caused by the formation of the holding company.

This decision will be narrowly limited by the Board to its facts; and the factual distinctions from almost all other applications are:

a. The debt owed by the owners already exists, and will exist, whether or not the holding company is formed. It is not incurred in this transaction.

b. The debt arose when the present owners bought out a felon.

c. Holding company status will allow the present owners to keep the bank, through the tax saving, and their management is desirable and approved.

d. The holding company is being formed in a State with no branching and no chain banking; it cannot, therefore, be the precursor to a chain of banks.

e. The holding company has no other business than the ownership of bank shares; its "management resources" need only be sufficient to vote at an annual meeting of the bank and see to the filing of a consolidated tax return.

This "First Lincolnwood Corporation" bears no resemblance to the massive one bank holding companies found in New York and in other states allowing chain or branch banking. This decision will be limited closely by the Board, as was the adverse decision in *Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973). See *Jackson Hole Banking Corp.*, 63 Fed. Res. Bull. 934 (1977).

We submit that the Courts of Appeals will formulate a body of law on the subject matter of bank holding companies which will, in due time, present an appropriate case for review. This case, while involving $130,000

per year in tax savings to the principals, does not, we submit, have that level of national importance which we understand is expected of cases accepted for review in this Court.

CONCLUSION

We respectfully pray that the Petition for a Writ of Certiorari be denied.

Respectfully submitted.

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